

## **TEACHERS' RETIREMENT BOARD**

### **REGULAR MEETING**

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SUBJECT: Update on State Legislation

ITEM NUMBER: 7a

ATTACHMENT(S): 1

ACTION: X

MEETING DATE: August 5, 1998

INFORMATION: \_\_\_\_\_

PRESENTER: Ms. DuCray-Morrill

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#### **Budget Update**

##### **Summary**

As of July 20, the Conference Committee on the Budget Bill is still meeting. The Committee adopted Budget Bill language included in the Senate version of the Budget Bill to require the System to perform a valuation on June 30, 1998 data to be completed by April 1, 1999 instead of waiting until June 30, 1999 data, when the next scheduled valuation is to be conducted. The Committee also approved an additional \$50,000 to pay for the valuation. Elder Full Funding contributions are not under immediate threat in the budget. Staff continues to work closely with client organizations, Legislative leadership, and the Administration regarding potential benefit increases.

##### **Recommendation**

The Staff continues to recommend the Board take no action at this time to deviate from the current schedule for conducting STRS actuarial valuations. Based on this schedule, the next valuation will be conducted on June 30, 1999 data and will be presented to the Board approximately March, 2000. The Board could choose to modify the current schedule at a future date if that action was deemed appropriate.

##### **Status of Board Sponsored Legislation for 1998**

Ms. DuCray-Morrill will provide a verbal update at the meeting on the current status of Board-sponsored legislation.

##### **MONTHLY STATUS**

Also attached for your information is a status report that represents the progress of legislation to date (Attachment I).

## BILL ANALYSIS

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**Senate Bill 1879,**

**Senators Hayden and Kopp**

(Amended 7/27/98)

**Proponents:**

**Agudath Israel of California,  
Association of Holocaust Survivors from the former USSR,  
Bet Tzedek Legal Services,  
Board of Rabbis of Southern California,  
Hebrew Union College,  
Hillel Council of Los Angeles,  
Kol Tikvah,  
Shaarey Zedek Congregation,  
University Synagogue**

**Opponents:**

**None known**

### **SUMMARY**

The bill declares the Legislature's intent to protect the public interest and satisfy the fiduciary and loyalty requirements of the state retirement boards, by prohibiting investments in certain Swiss banks and Swiss investments companies from January 1, 1999 until January 1, 2000, due to the lack of progress in the complete disclosure and return of Holocaust victim assets held by the banks.

### **HISTORY**

Although no prior legislation prohibiting investments in Swiss banks or Swiss investment firms, other legislation has prohibited various other investments.

Chapter 1254, Statutes of 1986, AB-134 (M. Waters) required divestment of state trust fund assets from companies doing business in or with South Africa. The Teachers' Retirement Board (Board) originally opposed the bill, but changed its position to neutral prior to the bill going to the Governor. The bill provided indemnification from the General Fund for Board members and investment managers of trust funds from any liability relating to the investment restrictions.

Chapter 31, Statutes of 1994, AB-2448 (Brown & Moore) repealed the prohibition of investments in South Africa established by AB-134. The Board took a support position on this bill. The repealed provisions provided indemnification from the General Fund for Board members and investment managers of trust funds from any liability relating to the investment restrictions.

Chapter 1351, Statutes of 1992, AB-2251 (Margolin) prohibits the investment of state trust funds in business firms or financial institutions that engage in discriminatory business practices after January 1, 1994 relating to the Arab League's economic boycott of Israel. Though the legislation was enacted, the State Teachers' Retirement System has not implemented its provisions pursuant to an opinion of the Attorney General (No. 93-302) stating that the provisions of AB-2251 are preempted by federal law (specifically the United States Export Administration Act). The Board opposed this bill. It provided indemnification for any lawsuits, judgements, etc., brought against the TRB, CalSTRS employees and investment managers.

AB 3445 (Knox, 1996), an earlier version of a tobacco products bill died in committee. The Board opposed this bill. It provided for indemnification for board members and their agents and employees.

AB-1744 (Knox, 1998), a tobacco products bill, is currently held in Assembly Appropriations Committee. The Board opposed this bill. It would: (1) prohibit new or additional investments by the State Teachers' Retirement Fund (TRF) and the Public Employees' Retirement Fund (PERF) in tobacco companies on or after January 1, 1999; (2) require phased divestment of one third of current holdings each year beginning January 1, 2000, and continuing until January 1, 2002; (3) require the Board to make specified investment valuations at specified intervals; declare that specified results of such valuations be considered as a normal cost deficit pursuant to Section 22955 (Elder Full Funding); and (4) require both CalSTRS and CalPERS to report to the Legislature on or after January 1, 2002 regarding the effect of the divestiture on employer contribution rates. The bill provides for indemnification for Board members and their agents and employees in the event of lawsuit.

SB-1433 (Hayden, 1998), a tobacco products bill, is currently on the Assembly Appropriations Suspense File. The Board opposed this bill. It would (1) prohibit new or additional investments by the TRF and the PERF in tobacco companies on or after January 1, 1999; (2) require CalPERS to report to the Legislature annually on and after January 1, 2003 regarding the effect on employer contribution rates of the prohibition against new or additional tobacco company investments; and (3) provide partial compensation to CalSTRS for investment earnings losses if there is a normal cost deficit.

## CURRENT PRACTICE

CalSTRS holdings of Swiss banking firms identified in the bill are as follows:

Company	Shares	Market Value (on 7/24/98)
1. Credit Suisse Group	601,980	\$147,605,811
2. Swiss National Bank*	none	none
3. UBS	<u>436,752</u>	<u>\$187,370,412</u>
<b>Total:</b>	1,038,732	\$334,976,223

CalSTRS holding of Swiss investment firms is estimated as follows:

Company	Shares	Market Value
1. Schweiz Bankverein	20,740	\$ 8,117,308
2. BQE Cant Vaudoise	40	\$ 16,190
3. Gotthard Bank	80	\$ 73,218
4. Vontobel Holdings AG	<u>60</u>	<u>\$ 107,781</u>
<b>Total:</b>	<u>20,920</u>	<u>\$ 8,314,497</u>
<b>Grand Total:</b>	1,059,652	\$343,290,720

\* The Swiss National Bank is a quasi-governmental unit, equivalent to our Federal Reserve.

The amount of STRS' funds invested in these banks and firms represents less than 1/2% of the total STRS portfolio.

## DISCUSSION

SB-1879 prohibits additional or new investments or business arrangements utilizing state trust funds or state trust moneys with specified Swiss banks or Swiss investment firms, as determined in the bill, from January 1, 1999 until January 1, 2000. During that time period, state moneys could not be deposited with or used to make any business arrangements or transactions with Swiss banks or Swiss investment firms. The prohibition wouldn't apply (1) if the bank or firm receives a written resolution from the Treasurer, in consultation with the advisory task force created by this bill, that it has made a satisfactory settlement with the parties currently involved in the issue concerning assets of Holocaust victims held by Swiss banks ; (2) to any loan or extension of credit for which an agreement is entered into before 1999; and (3) to any defined contribution plan administered by the Department of Personnel Administration pursuant to Section 401(k), 403(b) or 457 of the Internal Revenue Code.

The bill establishes within the office of the Treasurer a thirteen member advisory task force, which would serve without compensation. The task force would submit findings and recommendations to the Legislature and Governor concerning the degree of cooperation

by Swiss banks and Swiss investment firms, the settlement of claims, the resolution of historical conflicts, the extent to which tangible benefits have been provided for survivors, and the need, if any, for further legislative action. Additionally, this advisory task force would be consulted by the Treasurer when the Treasurer is determining whether to permit the state to resume investing or doing business in the restricted firms .

The U.S. State Department has expressed a concern about state proposals restricting investments in and business with Swiss banks and investment firms because individual state action may hinder the ability of the United States to speak with a single voice on a foreign policy issue. When the restrictions on investing in firms participating in the Arab League boycott was being considered by states, federal legislation was enacted which effectively prohibited such restrictions.

As have other proposals concerning which restrict the investment of CalSTRS in selected firms or industries, this bill interferes with the Board's fiduciary duty to invest funds for the benefit of its members. In addition, CalSTRS views the impact of the proposed prohibition on the TRF investment portfolio as having three separate fiscal considerations: (1) impact on investment returns; (2) impact on transaction costs; and (3) costs associated with selecting alternative investments.

The greatest portfolio impact would be seen in the holdings of the Swiss bank stocks, and the possible loss of investment return from lost investment opportunities. Although the bill does not require divestment of assets, it does reduce the universe of potential future investments. The impact of this reduced number of permitted investments would depend on the rate of investment return from the prohibited stocks, compared to the rate of return that would be realized from the investments which would be made under the bill with the funds. CalSTRS has no information at this time on the relative performance of the prohibited investments. If the prohibition results in a financial loss to the portfolio, then the System should contemplate seeking a legislative remedy to provide State funding for any "losses" resulting from such a prohibition, in order to make the System "whole".

CalSTRS also would likely incur costs in clearing and settlement transactions on trades which themselves are not prohibited, but which might be routed through Swiss banks or investment firms that are restricted. These restrictions probably would increase the cost of conducting transactions using alternative firms. CalSTRS has no estimate on how much transaction business currently is carried out with the prohibited firms. To evaluate this impact, CalSTRS would need a list of the sub-custodians and the amount of transactions done by investment firms that CalSTRS could no longer use. The additional transaction costs could exceed the level of foregone investment opportunities .

With the prohibition against Swiss banks and Swiss investment firms as investments, CalSTRS would have to find alternative investments for indexed portfolios. Costs would be associated with researching alternatives and ultimately making investment selections.

Finally, in addition to not indemnifying the fund against investment losses, the bill does not provide any indemnification for present, future and former members of the TRB, state officers and employees, and investment managers under contract with the state.

## **FISCAL IMPACT**

Unknown at this time - CalSTRS expects to see an impact from at least three considerations: (1) impact to investment returns; (2) impact to transaction costs; and (3) costs associated with selecting alternative investments. It is not possible to predict future returns, nor can CalSTRS identify the magnitude of potential increased transaction costs or the cost of identifying alternative investments

## **RECOMMENDATION**

Oppose -Staff recommends an oppose position on this bill. It interferes with the fiduciary responsibility of board to invest the retirement funds, restricts the investment universe, does not provide indemnification to the fund for present, future or past members of the TRB and the advisory task force appears to have authority over the investments of the fund without commensurate fiduciary responsibilities. Additionally, we have been unable to gauge the extent to which normal investment operations will be hurt by the restriction against business transactions and arrangements with Swiss banks and investment firms.

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CA AB 1150    AUTHOR:     Prenter and Ashburn  
                   TITLE:     STRS Benefits  
                   AMENDED:  06/22/98  
                   LOCATION: Senate Appropriations  
                   POSITION:    \*Support, if amended

SUMMARY: Identical to AB-2616 (Prenter) which was held under submission in Assembly Appropriations Committee on 05/21/98. Would incrementally increase the benefit factor of 2% at age 60 to 2.418% at age 63.

**COST:** Program - 2.228% of payroll, \$364,278,500 annually  
Administrative - One time cost of \$150,000, of which \$100,000 is absorbable. START costs undetermined at this time

P - Authors (Sponsors), CTA, CRTA, UTLA  
O- None Known

CA AB 1166 AUTHOR: House  
TITLE: Minimum Standards for Community College Counselors and Librarians, Part Time and Adult Ed  
AMENDED: 06/04/98  
LOCATION: Senate Appropriations  
POSITION: \*Co-sponsor

SUMMARY: Would: 1) establish a minimum standard of 175 days or 1,050 hours for full-time service and compensation for California community college counselors and librarians; 2) modify the minimum standard service for adult education programs, and part-time credit and non-credit and adult education community college instructors; and 3) make technical amendments to PERS law.

COST: Program - None  
Administrative - Minor, absorbable

P - PERS, STRS (Co-sponsors), CFT, FACCC  
O- None

CA AB 2765 AUTHOR: Assembly PER&SS  
TITLE: STRS Technical Housekeeping  
AMENDED: 05/22/98  
LOCATION: Senate Appropriations  
POSITION: \*Sponsor

COST: Program - No net costs, any program costs paid by participating employees  
Administrative - None

CA AB 2766 AUTHOR: Assembly PER&SS  
TITLE: Final Comp for LAUSD  
AMENDED: 04/20/98  
LOCATION: Senate Appropriations  
POSITION: \*Oppose

**COST:** Program - No net costs to system; LAUSD would be required to pay the actuarial present value of any benefit increase  
Administrative - Significant, approximately \$500,000 for implementation of the LAUSD final compensation proposal

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CA AB 2768    AUTHOR:     Assembly PER&SS  
                   TITLE:     Board Elections  
                   LOCATION: Senate Third Reading  
                   POSITION:  \*No Position

SUMMARY: Would require that the four “teacher” members of the TRB be elected to the Board from their respective constituencies rather than appointed by the Governor.

COST: Program - None  
 Administrative - \$614,296 per election cycle, or \$153,574 per year  
 Annual costs would vary according to the Board composition under election

P - PER&SS (Sponsor), ART, CTA, CFT, CRTA, FACCC  
O - None Known

CA AB 2804 AUTHOR: Assembly PER&SS  
TITLE: STRS' Benefits  
AMENDED: 05/13/98  
LOCATION: Senate Appropriations (Suspense File)  
POSITION: \*Support

SUMMARY: Would provide that when the TRF achieves full-funding, a continuous General Fund appropriation shall be made to the TRF for benefit increases and educational objectives.

**COST:** Program - \$36 million initial increase in resources to TRF from General fund, increasing annually for 17 years  
Administrative - None

P - Assembly PER&SS (Sponsor), ACSA ART, CFT, CRTA, CTA, FACCC, FCPHE, STRS, UTLA  
O - None Known

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CA SB 1433    AUTHOR:    Hayden  
                   TITLE:    Tobacco Investments  
                   AMENDED: 06/15/98  
                   LOCATION: Assembly Appropriations (Suspense File)  
                   POSITION: \*Oppose

**COST:** Program - Unknown. Although the potential losses from divestment are no longer an issue, there would still be significant lost opportunity costs associated with the restricted definition of “tobacco company”, only partially potentially compensated by the General Fund.

Administrative - Unknown, but likely significant costs associated with maintaining a phantom portfolio to conform to the requirements of the annual report to the legislature, as well as monitoring all future investments against the definition of “tobacco company”.

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CA SB 2047    AUTHOR:     Lewis  
                  TITLE:     Change in Option  
                  AMENDED: 06/24/98  
                  LOCATION: Assembly Consent Calendar  
                  POSITION:  \*Sponsor

**COST:** Program - No net costs to system, any selected options would be actuarially neutral  
Administrative - Approximately \$125,000 is estimated as the cost for system modifications, printing, and postage necessary for the implementation of the change in options and the greater of the option factors

P - STRS (Sponsor), ACSA, CFT, CTA, CRTA, Family Law Section of State Bar of California  
O - DOF

CA SB 2085    AUTHOR:     Burton  
                  TITLE:     STRS Cash Balance Plan  
                  AMENDED:  07/06/98  
                  LOCATION:   Assembly Third Reading  
                  POSITION:  \*Co-sponsor

**COST:** Program - No fiscal impact  
Administrative - None

P - CFT, CRTA, FACCC, STRS (Co-sponsors)  
O- None Known



## LEGEND OF ABBREVIATIONS

P = PROPONENTS    O = OPPONENTS

<b><u>ABBREVIATION</u></b>	<b><u>ORGANIZATION</u></b>
AALA	Associated Administrators of Los Angeles
ACCCA	Association of California Community College Administrators
ACLU	American Civil Liberties Union
ACS	American Cancer Society
ACSA	Association of California School Administrators
AFSCME	American Association of State, County and Municipal Employees
AFT	American Federation of Teachers
AGENCY	State and Consumer Services Agency
AHA	American Heart Association
ALA	American Lung Association
ALADS	Association for Los Angeles Deputy Sheriffs
ART	Association of Retired Teachers
AGO	Attorney General's Office
BOE	Board of Equalization
BOG	Board of Governors, California Community Colleges
Cal-Tax	California Taxpayers Association
CalPIRG	California Public Interest Group
CASBO	California Association of School Business Officers
CCA	Community College Association
CCAE	California Council for Adult Education
CFA	California Faculty Association
CFT	California Federation of Teachers
CHA	California Heart Association
CPOA	California Peace Officers' Association
CPCA	California Police Chiefs' Association
CPFFA	California Professional Firefighters Association
CRTA	California Retired Teachers Association
CSAC	California Association of Counties
CSBA	California School Boards Association
CSEA	California School Employees Association
CSL	California Senior Legislature
CSU	California State University
CTA	California Teachers Association
DOE	Department of Education
DOF	Department of Finance
DGS	Department of General Services
DPA	Department of Personnel Administration
FACCC	Faculty Association of California Community Colleges
FCPHE	Faculty Coalition for Public Higher Education
FTB	Franchise Tax Board

## LEGEND OF ABBREVIATIONS

P = PROPONENTS    O = OPPONENTS

<b><u>ABBREVIATION</u></b>	<b><u>ORGANIZATION</u></b>
FSC	Free Speech Coalition
LADSA	Los Angeles Deputy Sheriffs' Association
LAUSD	Los Angeles Unified School District
MPAA	Motion Picture Association of America, Inc.
OCDE	Orange County Department of Education
PARS	Public Agency Retirement System
PRF	Public Employees Retirement Fund
PERS	Public Employees Retirement System
RPEA	Retired Public Employees Association
RIAA	Recording Industry Association of America
SACRS	State Association of County Retirement Systems
SCDSA	Sacramento County Deputy Sheriffs Association
SBMA	Supplemental Benefit Maintenance Account
SDCOE	San Diego County Office of Education
SEIU	Service Employees International Union
SLC	State Lands Commission
SSC	School Services of California
SSDA	Small School Districts' Association
START	State Teachers' Automation Redesign Team
STRS	State Teachers' Retirement System
TFD	Teachers for Fair Disability
TRB	Teachers' Retirement Board
TRF	Teachers' Retirement Fund
TRL	Teachers' Retirement Law
USERRA	Uniformed Services Employment and Reemployment Rights Act
UTLA	United Teachers Los Angeles

### **STANDING COMMITTEES OF THE ASSEMBLY/SENATE**

Assembly PER&SS	Assembly Public Employees Retirement and Social Security
Senate IR	Senate Industrial Relations